

Fiscal Policy

DO NOW!

- ▶ Use your resources to find out what fiscal means. Write it in your own words.

The Employment Act of 1946

- ▶ “The Congress hereby declares that it is the continuing policy of the Federal Government to use all practicable means...to promote maximum employment, production, and purchasing power.”

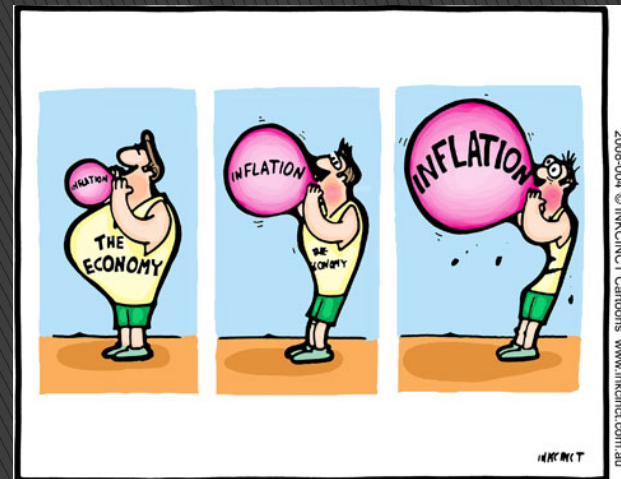
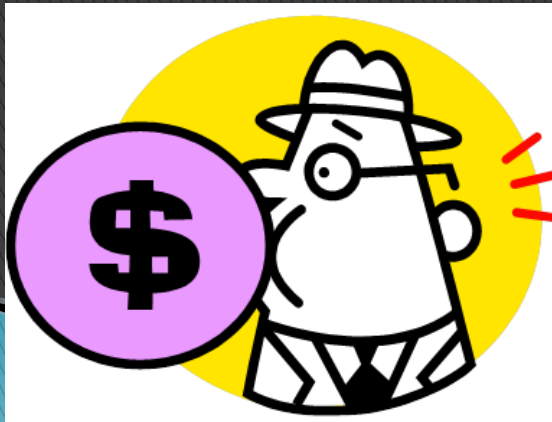
Fiscal Policy

- ▶ The use of federal government spending and taxes to achieve economic goals



Types of Fiscal Policy

- ▶ Expansionary
 - Increase in federal government spending or a reduction in taxes to increase real GDP.
- ▶ Contractionary
 - Decrease in federal government spending or an increase in taxes to decrease real GDP.

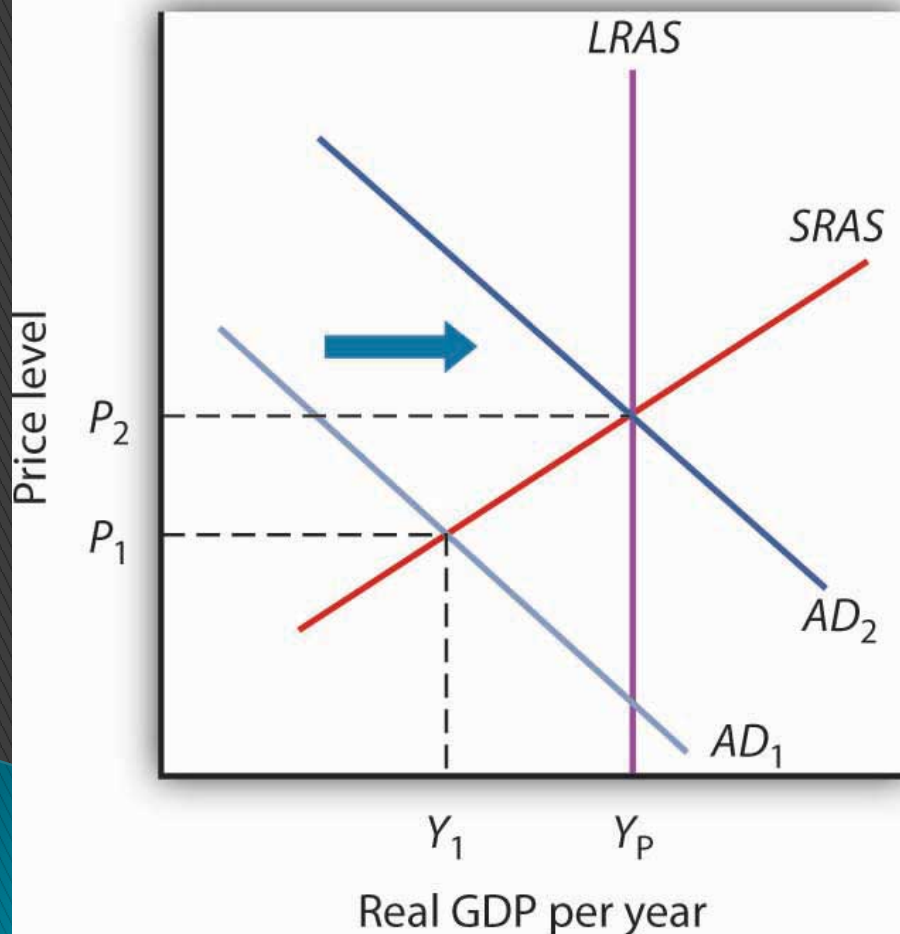


AD/AS Model

- ▶ **Aggregate Demand**
 - Shows real GDP that will be purchased at different price levels.
- ▶ **Aggregate Supply**
 - Shows real GDP that will be produced at different price levels
- ▶ **Macroeconomic equilibrium**
 - Price level where the aggregate demand (AD) intersects the aggregate supply (AS)

Types of Fiscal Policy

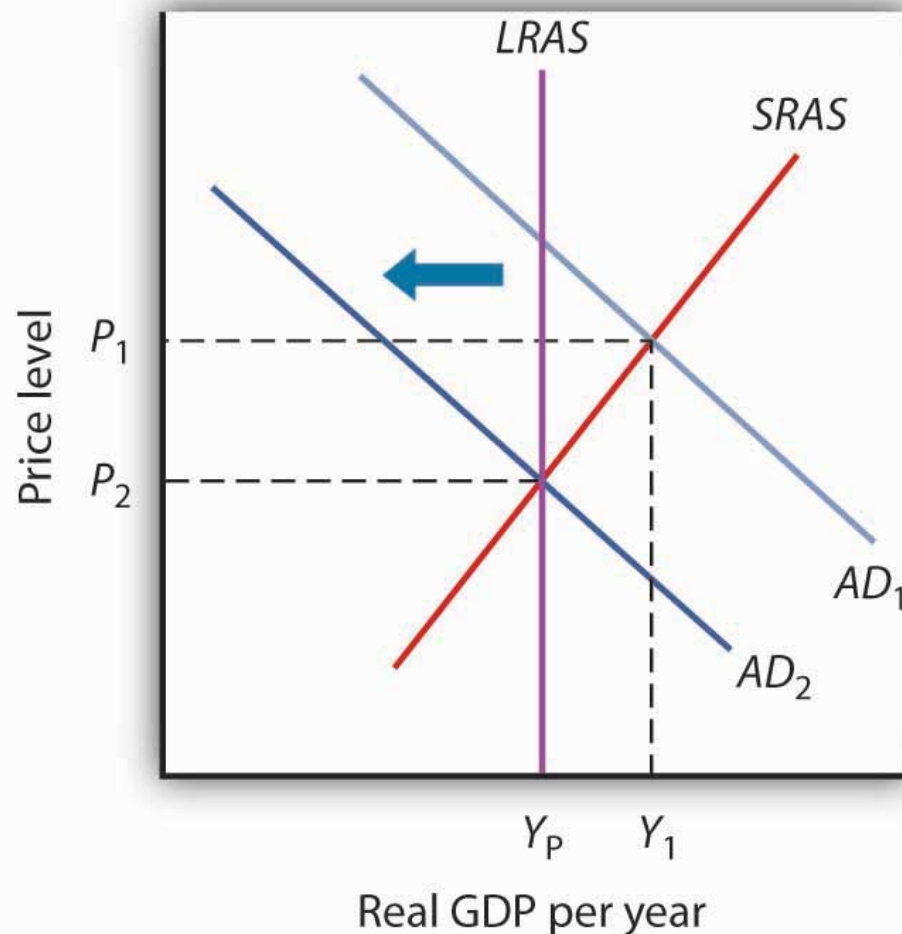
Panel (a)
Expansionary Policy



Long run

Short run

Panel (b)
Contractionary Policy



Classical vs. Keynesian

▶ Classical Economics

- Theory that free markets will restore full employment in a recession without government intervention

▶ Keynesian Economics

- Theory that the federal government should increase or decrease aggregate demand to achieve economic goals.

Timing Problems

- ▶ **Recognition lag**
 - The time it takes policymakers to recognize that unemployment or inflation have become a serious national problem
- ▶ **Administrative lag**
 - The time it takes to change government spending or taxes once the problem with unemployment or inflation is recognized
- ▶ **Operational lag**
 - The time between adopting the change in government spending or taxes and when the policy begins to have an effect on the economy's output, employment, or price levels

Automatic Stabilizers

- ▶ Fiscal policies that, without any new action by Congress or the president, decrease government expenditures or increase tax revenues during periods of rising inflation and falling unemployment, and increase expenditures or reduce tax revenues in times of rising unemployment and low or falling inflation